



September 7, 2007

To: Members of the Board

From: Wendy M. Comes, Executive Director and
Richard Fontenrose, Assistant Director

Subject: Social Insurance,¹ Tab C

This memorandum presents two Sections. Section I, "Points of Consensus," briefly reiterates the broad areas where there is a consensus, for members to consider and confirm. Section II, "Issues for Discussion," presents display issues and pro forma alternatives for discussion.

The objective of this session is to obtain the members' opinions regarding the essential information the Board wishes to communicate and options for altering the reporting model to meet communication challenges. Staff believes that addressing the reporting alternatives for information about social insurance will be more efficacious than articulating concepts that support multiple alternatives for communicating/representing a complex financial arrangement.

I. Points of Consensus

There is a consensus among members regarding the following components of a social insurance standard, which primarily involve display:

- A. Retain the Statement of Social Insurance (SOSI). Some aspects of the format for the SOSI are yet to be determined, but the staff assumes that the SOSI will continue to require five years of data and therefore provide information about trends.
- B. Add a statement of changes in SOSI amounts. The format for the statement of changes is yet to be determined. The Primary View proposed expanding the SOSI. The Alternative View proposed a separate statement. Mr. Reid recently suggested expanding the SOSI to explain, for example, how much of the change is due to work in covered employment in the current year, how much is due to benefits paid out during the current year, and how much to changes in assumptions.
- C. Retain the SFFAS 17 required supplementary information (RSI).

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

- D. Consider changes to the Statement of Changes in Net Position and other basic financial statements to display social insurance information. The possibilities include a new line item(s) and/or section(s) for the current statements as well as a new basic statement to bridge the Balance Sheet, Statements of Changes in Net Position and of Net Cost, and/or the SOSI.

II. Issues for Discussion

A great deal was learned through due process and, at the last meeting, the Board voted to proceed with the Social Insurance Project while working concurrently on fiscal sustainability reporting. Staff believes a principal issue is finding a way to communicate essential information² to users. This requires that we consider how users may interpret information about a national government.

Many of the respondents that supported the Alternative View and opposed the Primary View focused on the notion that use of the term “liability” is inappropriate with respect to amounts greater than the due and payable amount. In contrast, comments supporting the Primary View expressed concern that presenting a balance sheet purporting to include – through recognition and summation to a single “net position” – assets and liabilities that are measurable while *excluding* any social insurance (SI) amounts greater than due and payable would be misleading.

Many respondents offered insights regarding the scope (e.g., inclusion or exclusions of specific programs), specific measurement approach (e.g., selection of specific flows to include), and other aspects of the proposals. Staff suggests that these matters be set aside for now. We suggest instead that the Board focus on the essential information it wishes to communicate and options for altering the reporting model to meet the communications challenges in this environment.

Staff is aware that this project has significant ramifications for the conceptual framework. At this time, our conceptual framework includes reporting objectives that have been re-affirmed, an existing reporting model that is not fully described in Concepts Statement 2 (*Entity and Display*) and will be refreshed/completed, concepts regarding the reporting entity (under review), a target audience for the Financial Report of the US Government (FR), and a framework for Management’s Discussion and Analysis (MD&A). We are about to complete a statement defining elements of accrual-basis financial statements and basic recognition criteria. In addition, we are actively working on communications method guidance. As in all projects, the Board’s proposal must be explained in the context of the concepts statements.

By focusing on the best means of communicating essential information, we will consider new reporting alternatives that may or may not align with current element definitions or current statements. As reporting alternatives narrow, staff will begin evaluating each against the element definitions, current concepts of recognition versus disclosure, and implications for other statements in the reporting model (e.g., through articulation). Staff believes addressing the reporting alternatives for information about social insurance first

² “Essential information” is information necessary to meet the reporting objectives with respect to social insurance programs. In this context, the focus will be on information not currently conveyed through the SOSI, notes and supplementary information under SFFAS 17 as amended.

will be more effective and efficient than articulating concepts that support multiple alternatives for communicating/representing a complex financial arrangement.

Discussion of Objectives

The federal financial reporting objectives of operating performance and stewardship are:

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.

The *Preliminary Views* document (see page 7 of *Preliminary Views*) indicated that members supporting the Primary View wished to convey:

1. the estimated economic cost of social insurance incurred in each reporting period
2. the amount of these [incurred] costs that will have to be financed in future periods
3. the reasons for changes in the net present value of program related cash flows

Staff has developed rough alternative presentations that seek to include this information. Before we discuss these alternatives, we would like to ask the members views on the following questions:

- SI1. The Statement of Net Cost (SNC) – as currently designed – seeks to convey the gross and net cost of goods and services provided. It reports all costs less any associated exchange revenue. With some exceptions (related to intra-governmental sales), the bottom line is the amount that – over time – must be financed by non-exchange revenue and other financing sources. Currently, social insurance costs essentially represent SI benefits paid during the period plus the net change in the “due and payable” liability. SI payroll taxes are classified as non-exchange revenue and therefore reported on the Statement of Changes in Net Position.

Given the objective of the Statement of Net Cost, what – if anything – do you believe distinguishes the “estimated economic cost of social insurance” incurred in each reporting period from the cost of other programs?

- SI2. The Statement of Changes in Net Position (SCNP) presents the net result of the entity's operations calculated by deducting from the net cost of operations – drawn from the SNC – the financing for that net cost. (A positive result – an increase in net position – means more financing was available than cost, and a decrease means that financing will be needed in the future to reduce the incurred liabilities.) It articulates with the Balance Sheet (that is, Balance Sheet changes link mathematically with the SCNP so that the SCNP explains through categorization and related narrative the changes in net position during the year).

Does the “estimated economic cost of social insurance” incurred in each reporting period differ from other costs because of the financing arrangement? If so, is it useful to include these amounts in the same categories as other amounts for which financing is less clear? For example, some have argued that it is misleading to focus on accrued amounts for which financing arrangements – future payroll taxes – are already established.

- SI3. The Balance Sheet displays the stocks of assets and liabilities of the entity. Net position is the difference between assets and liabilities. SFFAC 2, *Entity and Display*, requires separate display of certain types of assets and liabilities.

85. Assets the reporting entity holds and has the authority to use in its operations should be displayed separately from assets the entity holds but does not have the authority to use. Likewise, liabilities for which budgetary authority has been received for liquidating the liabilities should be displayed separately from liabilities for which budget authority has not been received (even if the authority is expected). Assets and liabilities arising from transactions among Federal entities should be displayed separately from assets and liabilities arising from transactions with non-Federal entities.

To date, we have displayed all assets and liabilities on one statement. However, this is not true of all elements. For example, exchange revenues are displayed on the SNC and non-exchange revenues are displayed on the SCNP. Despite the 16-year history of FASAB, we are still in the early stages of standard setting. Some issues that have not yet been discussed by the Board include taxes that relate to current earnings but which will not be collected until a much later triggering event (taxes on tax deferred accounts) and treaty obligations. Staff expects that many of the arguments posed with regard to SI will be raised when and if we address these types of activities.

Is there a sufficient distinction – perhaps based on the continuum described by some respondents – between the stock amounts (assets and liabilities) arising from transactions and events with “equivalents” in settings other than the national government and those arising with special significance at the national government level? For example, are “social contracts” so different from other contracts that they should be displayed in a distinct manner (e.g., with a clear “black box” warning)? Are assets arising from current tax policy but which will not be converted to cash for decades (and most likely at different tax rates) different than other long term receivables or investments?

- SI4. The Statement of Social Insurance (SOSI) displays present values of future inflows from and outflows to three groups – current participants who have attained the minimum age necessary to receive benefits, current participants who have not yet attained the minimum age necessary to receive benefits, and future participants – over a 75-year time period. The bottom line is the difference between the present value of future scheduled benefits and future earmarked receipts; that is, the shortfall of financial resources available under current law to cover the cost associated with scheduled benefits for the period. Currently, there is no requirement to explain the changes in these amounts but the Board consensus is to add such requirements. In addition, no subtotals displaying net amounts attributable to either different groups (e.g., the closed group which excludes future participants) or past versus future participation (e.g., the

maximum transition cost³) are required. Currently, the SOSI is not linked to and does not articulate with the balance sheet. Also, since it does not currently offer an explanation of the changes in amounts, it also is not linked to and does not articulate with the SNC or SCNP. Also, the elements presented on SOSI are defined⁴ independently of the elements presented in the accrual-basis financial statements.

The SOSI presents all inflows and outflows (for the specified time periods) for the SI programs, makes distinctions between flows attributable to various groups (as currently done), and could distinguish between amounts linked to the past (e.g., through work in covered employment occurring before the reporting date). Do members perceive an advantage to a display that presents information in the context of a continuing program with earmarked revenue? (By “context”, staff is suggesting that disaggregation could be used to display various aspects of the present value of future flows while ensuring that all aspects related to the program are presented on a single statement.) For example, it is conceivable that the net present value of all flows for an SI program approximates zero but there is a significant amount attributable to the past; presenting such results in a single statement ensures that any disaggregated information is conveyed in the context of the whole. Also, it is feasible that assessing the impact of policy changes related to a single SI program may be facilitated by presentation of all the policy impacts (e.g., cuts in benefits attributable to the past as well as the future and increases in future taxes) on a single statement.

Alternatively, do members believe that context could be provided through linkages between the financial statements? For example, the Financial Accounting Standards Board and the International Accounting Standards Board are undertaking a project on financial statement presentation and envision consistent categories across all statements for items relating to business, discontinued operations, financing, equity and income taxes. In theory, categorization and definitions along a continuum could aid in making the link between accrual basis statements and the forward looking projections of cash flows envisioned in fiscal sustainability reporting. For example, any projected cash flows will include cash derived from assets or required to settle liabilities recognized on the balance sheet. Are there benefits to disaggregating the elements presented on fiscal sustainability reports such that future flows related to existing assets and liabilities are distinguishable from those not so related?

³ Maximum transition cost equals accrued benefit obligations less trust fund assets and the present value of taxes on future benefits. (Accrued benefit obligations—This measure reflects future benefit obligations based on past earnings as of the valuation date. Thus, these accrued benefit obligations are relevant only to current participants as of the valuation date. The accrued benefit obligations are based on the primary insurance amount (PIA), the early retirement or delayed retirement factors, and other rules of payment. The accrued benefit obligations include (1) Benefits scheduled to be paid for current (i) retired-worker beneficiaries and (ii) disabled-worker beneficiaries who continue to be disabled after the valuation date. (2) Retired worker benefits based on PIAs determined as of the valuation date for workers who have reached benefit eligibility age (62) and are not yet receiving benefits. (3) Benefits calculated on a proportional past-service-credit basis determined as of the valuation date for current active participants under age 62. These benefits require a computation of a PIA (PIA_{DIB}), as of the valuation date, as if the worker had just become eligible to receive a disabled-worker benefit. These benefits are then adjusted so they may be viewed as benefit levels of a worker aged 62. The adjustments are made depending on the type of worker, as illustrated below. (Source: <http://www.ssa.gov/OACT/NOTES/ran1/index.html>))

⁴ The elements of SOSI are established in SFFAS 17 at paragraph 27(3).

The Board will face similar questions as it addresses a statement of changes in social insurance.

While the above questions are broad, staff hopes that they prompt ideas that inform consideration of alternative financial statement presentations.

Pro Forma Examples

- A. The pro forma illustrations start with the Balance Sheet. The Balance Sheet displays the asset and liability balances at the end of the period. Revenue/expense are defined in *Elements* as an inflow/outflow or other increase/decrease in assets, a decrease/increase in liabilities, or a combination of both that results in an increase/decrease in net position during the period. Alternatives for the **Balance Sheet** include:
1. Exhibit A1 – This Exhibit uses the current Balance Sheet but adds a section “below the line” displaying the present value of future SI benefits, for example, the closed group measure. This line item(s) could represent: (a) an existing element, i.e., a liability, that does not meet the other-than-basic recognition criteria involving measurement; or (b) a new element. These amounts could also tie to the SOSI.
 2. Exhibit A2 – This Exhibit is the same as immediately above but displays the present value of future outflows for other major programs as well as SI. The amounts would represent future claims on resources based on current law. For example, a projection of defense spending over the next 75 years, or whatever timeframe the Board decided upon in the measurement phase of the SI project.
 3. Exhibit A3 – This Exhibit is the same as immediately above but displays a new element included in the total “above the line,” that is, it could be “recognized” but displayed in a separate section.⁵ This line item(s) could represent: (a) an existing element, i.e., a liability, or (b) a new element. These amounts could also tie to the SOSI.

The above Balance Sheet exhibits are at the FR level rather than at the component entity level. Staff believes that the information display is transferable to component entity financial statements.

⁵ As the members well know, the terms “recognition” and “recognize” refer to the process of formerly recording or incorporating an element into the financial statements of an entity. Recognition comprises depiction of an element in both words and numbers, “with the amount included in the totals of the financial statement.” See *Elements*, par. 4 and Appendix B: Glossary.

B. Alternatives for the **statement that displays expenses:**

(Regarding the format for pro forma statements, alternatives for display of expense include both the FR operating statement and a component entity's SNC. Aside from the different titles for the respective statements, the FR operating statement combines operating activity with other changes in net position, while the component entity's Statement of Net Cost (SNC) does not. In any case, Staff believes that the proposed new information displayed could be displayed equally well with either operating statement format.)

As stated above, revenue/expense are defined in *Elements* as an inflow/outflow or other increase/decrease in assets, a decrease/increase in liabilities, or a combination of both that results in an increase/decrease in net position during the period. Thus, the decision with respect to the elemental nature of the change in the present value of SI commitments is fundamental to consideration of whether the change is an expense; and, therefore, whether the change should be above or below the line on the SNC.

1. Exhibit B1 – This Exhibit is based on Mr. Reid's⁶ July 2007 pro forma example but includes staff modifications to line item descriptions. It represents a new section for the current FR "Statement of Operations and Changes in Net Position" that displays estimated SI non-cash costs attributed to the current year. In the staff versions, this amount is included in a "total cost attributed to the current year" amount displayed on the pro forma statement but not as a component of net position. As with the above Balance Sheet examples, this line item could represent: (a) an existing element, i.e., the change in the non-recognized liability during the period, or (b) a new element. In Mr. Reid's pro forma example, it ties to the SOSI. See Exhibit D3 below.

Mr. Reid provided the following explanation to staff:

This alternative is a "trial balloon." Its intent is not to advocate either the Primary or Alternative Views but simply to put some ideas down that might better communicate the critical message.

This alternative uses existing financial statement infrastructure (with slight modification) to call attention to social insurance sustainability. ...The focus is the statements of social insurance (SOSI) and of changes in net position (SCNP). It shows how powerful full cost information and further breakdowns of annual SOSI revenue and benefit can be. Present statements show only the changes in benefits caused by work performed in the current year. Much more granularity is needed.

2. Exhibit B2 – Using the component entity SNC format, this Exhibit presents the current SNC format to illustrate a section "below the line"

⁶ See page 14 of the July minutes for Mr. Reid's description of his suggestion. Staff also benefited from a mock up that Mr. Reid described as an initial attempt at revising the model and not a proposal.

displaying the change in the present value of SI benefits. The question of the elemental nature of this line would need to be addressed.

3. Exhibit B3 – This Exhibit is the same as B2 immediately above but with the amount included in the total net cost. Again, the question of the elemental nature of this line would need to be addressed.

C. Alternatives for the **Statement of Changes in Net Position (SCNP):**
(The comments in section B immediately above regarding the different format between the FR and the component entities applies here as well. The FR operating statement combines operating activity with other changes in net position, while the component entity's Statement of Changes in Net Position (SCNP) carries over net amounts from the SNC. In any case, Staff believes that the proposed new information displayed could be displayed equally well with either operating statement format.)

1. Exhibit C1/B1 – See Exhibit B1 for Mr. Reid's pro forma example of a Statement of Operations and Changes in Net Position. Since this statement combines operating activities and changes in net position, it can serve here as well as in section B above.
2. Exhibit C2 – A new SCNP section displaying the amount – whether that is an "expense" or a change in a "commitment" or other amount – of the change in the reporting period "below the line."
3. Exhibit C3 – Same as C2 but including the amount of the change in the totals.

Mr. Reid suggested that the Statement of Changes in Net Position could array more than it currently does, and suggested a new line item for the benefits attributed to work performed in the current year would be useful. Amounts displayed on the Statement of Changes in Net Position could be related to the SOSI amounts and/or Balance Sheet amounts.

D. Alternatives for the **Statement of Social Insurance (SOSI):**

1. Exhibit D1 is the current SOSI from the FY 2006 FR, OASDI and Medicare, Part A.
2. Exhibit D2 is the SOSI from the Primary View, OASDI section, which shows line items that tie to balance sheet and SNC and presents a section displaying the changes in SOSI amounts.
3. Exhibit D3 is Mr. Reid's pro forma SOSI. It presents sections displaying the changes in SOSI amounts and line items, in the last section of the statement, that tie to the FR Statement of Operations and Changes in Net Position, as shown in Exhibit B1 above.

E. Alternatives for the **statement of changes in social insurance:**

1. See Exhibit D2 above for the sections of the Primary View SOSI dealing with changes during the period; and Exhibit D3, also above, for the treatment of changes in the Mr. Reid's pro forma statement.

2. Exhibit E2 is the Alternative View's statement of changes in the SOSI.

F. Alternatives for a **new statement:**

A new statement could present selected amounts from the financial statements and relate them to amounts on the SOSI. It could bridge the Balance Sheet and/or the Statement of Changes in Net Position and the SOSI.

1. Exhibit F1 is the recently discussed Table 1 from the FY 2006 FR Executive Summary.

This table could display additional indicators, of course, such as GDP, unemployment, inflation, net foreign debt, and others.

2. Exhibit F2 is a re-format of the data presented in Exhibit F1.